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Office of the Legislative Auditor

State of Montana

Report to the Legislature

June 1992

Performance Audit Report

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Montana Guaranteed Student Loan Program

Commissioner of Higher Education

This report contains recommendations for improving the management of the Montana Guaranteed Student Loan Program. The recommendations include:

- Strengthening management controls.
- Improving program review procedures.
- Formalizing computer system controls.

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Members of the performance audit staff hold degrees in disciplines appropriate to the audit process. Areas of expertise include business and public administration, statistics, economics, computer science, communications, and engineering.

Performance audits are performed at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of four members of the Senate and four members of the House of Representatives.

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STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:
MARY BRYSON
Operations and EDP Audit
JAMES GILLETT
Financial-Compliance Audit
JIM PELLEGRINI
Performance Audit

June 1992

The Legislative Audit Committee
of the Montana State Legislature:

We conducted a performance audit of the Montana Guaranteed Student Loan Program of the Montana University System. This report contains recommendations concerning management controls and computer systems. A written response to this report from Montana Guaranteed Student Loan Program is contained at the end of this report.

We wish to express our appreciation to the Commissioner of Higher Education and Montana Guaranteed Student Loan Program staff for their cooperation and assistance.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

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Office of the Legislative Auditor

Performance Audit

Montana Guaranteed Student Loan Program

Commissioner of Higher Education

Members of the audit staff involved in this audit were Pamela M. Boggs, Tom Cooper, Ken Erdahl, Angie Grove, Jim Nelson, and Jill Olson.

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Report Summary

Introduction

At the request of the Legislative Audit Committee, we conducted a performance audit of the Montana Guaranteed Student Loan Program (MGSLP). We reviewed central program operations conducted in Helena. Program operations at schools and lenders were not audited during this review. The objectives of the audit included determining if appropriate management controls over the program are in place and if federal compliance monitoring is performed at the school and lender level. Controls over applicable computer systems were also examined.

Program Description

The Guaranteed Student Loan Program is a federal program administered at the state level. There are now three different loans available in this program: Stafford loans, Parent Loans, and Supplemental Loans. The program enables students and parents to borrow directly from participating lenders (banks, credit unions, savings and loan associations). The intent of the original Guaranteed Student Loan Program was to assist students who were ineligible for federal grants and who were unable to afford a post-secondary education. The program was intended to assist middle income families. The Parent and Supplemental loans are now meant for middle-income students. The Stafford program is now geared more toward low-income students.

The Guaranteed Student Loan Program is under the direction and supervision of the Board of Regents. The Regents have given responsibility for the Montana student loan program to the Commissioner of Higher Education's office. The commissioner has established the Montana Guaranteed Student Loan Program (MGSLP) to perform the federally required functions of administering student loans. The funding for this program is provided through borrower fees and the federal Department of Education. During fiscal year 1990-91 MGSLP guaranteed approximately 23,000 loans for a total of over $57 million to eligible students. The cumulative volume of loans made since the inception of the program is over $300 million.

There are approximately 165 lenders and 35 in-state post-secondary institutions that participate in the loan program. Educational institutions include tribal and public community

Sampling Procedures Could be Improved

Current agency procedures do not outline methods for calculating or projecting sample results to the loan population. Even for errors that are identified by reviewers, there is no formal method for corrective action. To get better, more confident estimates of actual error rates, the number of loans reviewed (sample sizes) would have to be increased. Improved procedures could assist in determining compliance with federal guidelines. Reviewers could also identify areas where training or technical assistance may be needed.

By using statistical methods to determine sample sizes and evaluate results, the program could further rely on its methods for ensuring quality. Statistical sampling would add independence and reliability to current procedures.

Quality Control Over Program Reviews

Currently there is no supervisory review of program reviewers' documentation or procedures. The working papers generated during a review do not receive any standard review. Actual duties performed are not observed on a periodic basis. We noted concerns with how samples are selected, in the procedures followed, and in the number of annual reviews performed. We found instances when data in the final written report did not correspond with information documented in the workpapers. Based on these findings, we believe additional supervisory review is needed. Periodic reviews of staff activities provides confidence quality standards are met. MGSLP should establish quality control procedures to strengthen review activities and findings.

Service Agreement Could be Strengthened

We reviewed the service agreement between MGSLP and the private contractor who provides computer services, USA Funds. We looked for various elements which should be included in the agreement to ensure MGSLP contractually has a desirable level of service. The existing contract was compared with the suggested contract elements outlined by the American Institute of Certified Public Accountants' Audit and Accounting Guide, "Audits of Service-Center-Produced Records." We noted the

agreement does not cover several elements including USA Funds' responsibility for maintaining system controls.

Based upon our review, MGSLP management should consider the need for additional elements in their written agreement with USA Funds. A more comprehensive agreement would also provide additional assurance controls are in place over the electronic data. In addition, management should ensure the agreement includes a formal development plan for any future application development.

Agency Management Controls Over Database Access

Access to database functions is controlled through the application software managed at USA Funds. While performing audit work at USA Funds, we found 265 external personnel had access to Montana's database. Sixty-nine of these individuals had some form of write or update access to the database. MGSLP management was not aware of this external access. Given the number of users who had access, MGSLP has no method of ensuring all input is controlled.

Internally, we reviewed access MGSLP employees had to the database. Of the 20 users we tested, 14 had access which was not necessary for their job duties. Many of these users need access to generate reports but they also had access to all other functions. Essentially, this gives those employees the ability to write or make changes to database information even though their job duties do not require those type of activities.

Access to data files and programs should be limited to those individuals authorized to process or maintain particular systems. MGSLP should establish procedures to control access over these areas and maintain documentation of the access given to staff.

Improvements Could be Made in Database Accuracy

The purpose of the loan database is to provide accurate reporting and tracking of student loans. To test the accuracy of database information, we reviewed a statistical sample of student loans maintained on the system. This testing does not provide assurance over data maintained by schools and lenders. The accuracy

of data maintained at that level is tested by MGSLP during program reviews.

We compared borrower and loan information on the database to hard copy files at MGSLP and information maintained by MHESAC. We were not able to verify the accuracy of all information on the database because source documents were not always available. For items with available source documentation, we found examples of names and loan status that were not recorded consistently. We were able to conclude the error rates for the attributes tested ranged between 0 and 10 percent. Although the error rates are not unusually high, even a 10 percent error rate in the entire loan population (over 300,000 records) could indicate a large number of inaccurate records (up to 30,000 records).

By taking control over additional duties associated with the loan database, the agency has taken steps to control database information. MGSLP could strengthen this control by negotiating service agreement changes with its loan servicer and improving system controls. Activities outlined in the service agreement should be reviewed to determine if required activities are being performed.

MHESAC Agreement Needs Clarification

MGSLP relies on a computer system leased by MHESAC to transmit loan data from USA Funds to Helena. The agencies also share computer staff. MGSLP responsibility in relation to current computer operations is currently defined in a letter of agreement between the two agencies. The current agreement addresses primarily the form and frequency of billings. Other areas of responsibilities and required procedures are not adequately covered in the agreement. For example, each agency's responsibility for maintaining system controls has not been specified. Clarification of backup procedures, provisions for maintaining access security, and authority for entering transactions could be outlined.

Due to the limited information outlined in this agreement, MGSLP lacks assurance regarding the controls within MHESAC's computer environment. The missing contract

elements also increase the risk for disputes between MHESAC and MGSLP. Specific language related to the responsibilities, liabilities, and data ownership of the parties would decrease this risk.

Disaster Recovery Plans

A formal disaster recovery plan has not been established for MGSLP computer operations in Helena. Agency management has not devoted staff time to this project. This is an area that should be established as a staff priority by MGSLP management. Section 2-15-114(3), MCA, requires each department head to implement appropriate cost-effective safeguards to reduce, eliminate, or recover from identified threats to data and information technology resources.

Security Over Electronic Information

The security administrator should be the only person to use the computer's access control administration/security functions. We found six individuals with security access to computer files. We also noted five group logon IDs. One of these IDs has security access privileges. Security privileges usually allow the user to establish new users, access all data, change system software, change user passwords, and complete system maintenance. Given the size of this organization, we believe the number of individuals with security access within the organization should be limited.

We also noted programmers have write access to both data and programs by sharing logon IDs. Programmers have write access to programs used to submit warrant information for processing. These programmers also have write access to data which is used to process warrants. One person should not have write access to data and programs. The programmer who makes changes to the program should not be permitted to make data file changes.

There are several steps that can be taken to increase controls. Training can be provided to the designated security officer to provide technical assistance and to increase agency knowledge of security measures. Policies and procedures can be developed for all staff to follow. Duties should be segregated between programmers and data entry staff. MGSLP should also develop a

system for monitoring controls in this area and ensuring policies and procedures are followed consistently.

Overall System Management

There are several computer processing areas which are lacking defined controls and established staff procedures as identified in this report. The development of these controls and policies will require the expertise of senior level computer staff. Currently, MGSLP can request about 25-30 percent of senior level staff from the MHESAC computer staff. The requested staff time can be spent for MGSLP operations. The remaining computer staff time is designated for other university and MHESAC operations. The MGSLP staff time percentage is annually negotiated with MHESAC. We believe the areas identified in this report should be established as priorities for computer staff by agency management. Database integrity and security are critical areas for this program. Control weaknesses could affect the ability to continue operations.

Due to the good relationship between the two organizations, we believe these areas could be addressed while negotiating a new letter of agreement. The development of controls for MGSLP may require additional staff time, or a change in current staff priorities, for a limited period of time.

Chapter I
Introduction

Introduction

At the request of the Legislative Audit Committee, we conducted a performance audit of the Montana Guaranteed Student Loan Program (MGSLP). This program is administered for the Board of Regents by the Office of the Commissioner of Higher Education. We reviewed central program operations conducted in Helena. Program operations at schools and lenders were not audited during this review.

Audit Objectives

The objectives of the audit were to determine if:

-- Appropriate management controls over the program are in place and operating as intended.

-- Program administration is in compliance with applicable statutes and rules.

-- Program monitoring is performed at the school and lender level to ensure compliance with federal regulations.

-- Controls over applicable computer systems provide assurance over the access to and accuracy of program information.

-- Communication and coordination with the Montana Higher Education Student Assistance Corporation is effective.

Audit Scope and Methodology

The audit was conducted in accordance with government auditing standards for performance audits. Audit work focused on management controls and reliability of computer information. Testing of management controls included a review of internal controls over staff activities, adequacy of staff workloads, and availability of measurable program goals and objectives. Staff interviews and observations were completed to determine if position descriptions accurately represent duties performed. Training and performance evaluation records were examined to determine if staff needs are being addressed. Observations of all program activities were conducted to identify any workflow concerns.

We reviewed accuracy and availability of management information. Management reports and their uses were identified through staff interviews and observations. We reviewed files to determine possible areas of duplication or if additional information is needed.

We examined the level and amount of program monitoring for participating lenders and schools to determine if procedures could be strengthened. We interviewed staff and reviewed records to evaluate the level of control over staff activities. We accompanied program staff during their reviews to observe procedures and policies followed. Sampling procedures used to select files for review were analyzed. Documentation from past program reviews was examined to review staff decisions for consistency. We contacted a sample of lenders and schools to determine if they had any concerns or suggestions relating to program reviews or training. We based our review on intent outlined in program goals and objectives and staff input.

Computer systems were reviewed to determine accuracy of database information and to ensure controls over automated information provided a secure environment and accurate processing. We visited the data processing center in Indianapolis to test controls over that facility. Facility tours, staff interviews, and documentation reviews were performed at the center. Controls were also tested in Helena. Data accuracy was tested by comparing computer file information to source documents. We examined personnel access to information maintained on the database.

We reviewed the agreements between Montana Guaranteed Student Loan Program and Montana Higher Education Student Assistance Corporation (MHESAC) to determine how resources and program information are shared. (See pages 8 and 38 for further details on MHESAC.) Staff from both organizations were interviewed. We observed interaction and workflow between the two throughout the audit.

Compliance

We found the loan program to be in compliance with program laws and regulations except in certain areas. Areas of non-compliance included incomplete records management procedures and lack of a computer disaster recovery plan. These issues will be discussed later in this report.

We did not specifically test for federal compliance at the schools and lenders. Loan default rates were not evaluated. Compliance issues and default rates are reviewed by federal review staff, financial auditors, and Montana program personnel. We evaluated MGSLP procedures for monitoring federal compliance rather than duplicate other compliance reviews currently being performed.

Management Memorandums

During the course of the audit, we asked program officials for written responses to certain audit issues. In addition, we sent management memorandums on issues which were less significant. The issues addressed included:

-- Eliminating duplicate file information in a central read file.

-- Maintaining central staff training and personnel records.

-- Tracing loan history after correcting student social security numbers.

-- Adopting records retention policies and tracking records.

-- Utilizing other agency and private sector reviews of school loan operations to supplement program review findings.

-- Accurately documenting lender and school loan activity.

-- Incorporating physical controls into the new computer facility.

-- Documenting system software development and changes.

-- Periodically changing user passwords for the Helena computer.

Changes that Could Impact Future Reviews

During the past year the program installed an electronic imaging system. This system was installed to address record retention and file retrieval concerns. An imaging system can allow shared use of document images and reduce the amount of physical document storage space. Because this system was just being developed at MGSLP, we did not specifically test controls in this area. In the future, audits and other reviews will rely on this system to retrieve program records. Workflow and staff workloads will also be significantly impacted by this system.

To address the developments and changes related to using imaging systems for records management, the Department of Administration has established a committee of various data processing agency personnel. This committee is researching these systems and what direction agencies should go when developing these systems. Suggested committee guidelines should be available later this year.

Chapter II
Background

Background

This chapter provides an overview of Montana's Guaranteed Student Loan Program. This program offers several types of loans for post-secondary education. These are some of the largest loan programs available to post-secondary students. These programs are administered by MGSLP. This chapter describes the role and history of the programs, agency organization, and recent funding.

Introduction

Financial aid is offered to assist students in meeting post-secondary education expenses. Based on financial information provided by the student, the school will determine the amount the student and family can provide. The difference between this amount and the actual educational costs determine the student's level of financial need. Students may receive a combination of grants, work-study, and loans to meet their financial need. Students usually try to obtain grants first since no repayment is required. Work-study employment is most often the next option considered. If grant and work-study aid does not meet all expected financial need, student loans can be obtained. Loans require repayment of the original loan amount plus interest.

Program Description

The intent of the original Guaranteed Student Loan Program was to assist students who were ineligible for federal grants and who were unable to afford a post-secondary education. The program was intended to assist middle income families. Program philosophy was gradually changed by federal legislation. The program now includes three types of loans: Stafford, Parent, and Supplemental. The Stafford program is now geared more toward low-income students. The Parent and Supplemental loans are meant for middle-income students.

The Guaranteed Student Loan Program is a federal program administered at the state level. The program enables students and parents to borrow directly from participating lenders (banks, credit unions, savings and loan associations). To encourage lenders to participate in the loan program, secondary market organizations have been developed. These organizations purchase

student loans from the original lenders to provide these lenders with capital to re-invest in future student loans. Once the secondary market organization purchases the loans, they bear the responsibility of servicing the loan throughout the repayment process. Student loans are fairly simple to service while the student is in school, but become more labor intensive once the repayment period begins. Therefore, lenders normally sell the loans to the secondary market when the student leaves school. Most states have a secondary market with whom they do business.

Student loans are made at low interest rates, with extended repayment periods which begin after leaving school. Stafford loans range up to $7,500 per year, depending on financial need and year in school. The United States Department of Education pays loan interest on qualifying Stafford loans while the student attends school and for a stipulated period after leaving school.

The parent loan program (PLUS) and supplemental loan for students program (SLS) are part of the Guaranteed Student Loan Program. The PLUS program offers loans to eligible parents of dependent students. The SLS program provides additional aid to eligible independent students. The loan maximum for both the PLUS and SLS programs is $4,000 per academic year per borrower. Loan interest for these programs is the responsibility of the borrower.

Montana Program Organization

The Guaranteed Student Loan Program began in Montana in 1980. The program was authorized by the Montana Legislature and placed under the direction and supervision of the Board of Regents. The Regents have given responsibility for the Montana student loan program to the Commissioner of Higher Education's office. The commissioner has established the Montana Guaranteed Student Loan Program (MGSLP) to perform the federally required functions of administering student loans.

To be eligible for a Stafford Student Loan, a borrower must:

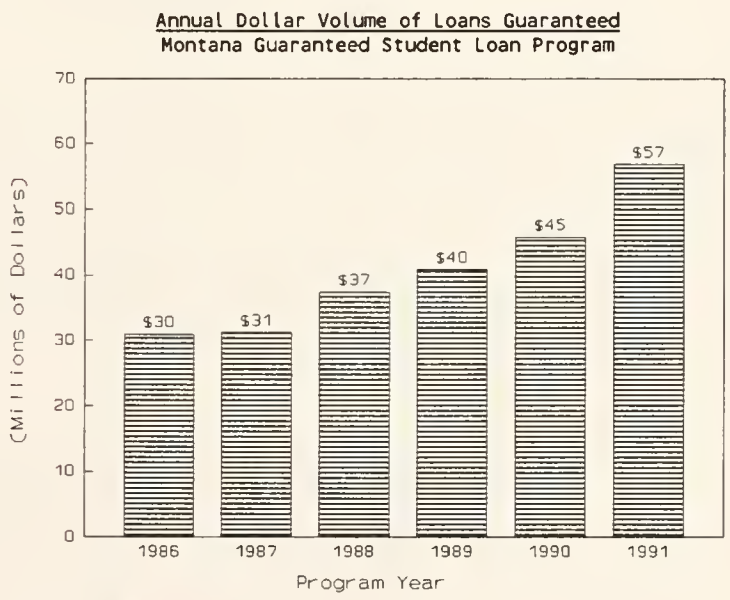
-- Be attending an accredited post-secondary educational institution in Montana, or

-- Be a Montana resident attending an institution outside Montana, or

-- Have an outstanding Montana Guaranteed Student Loan.

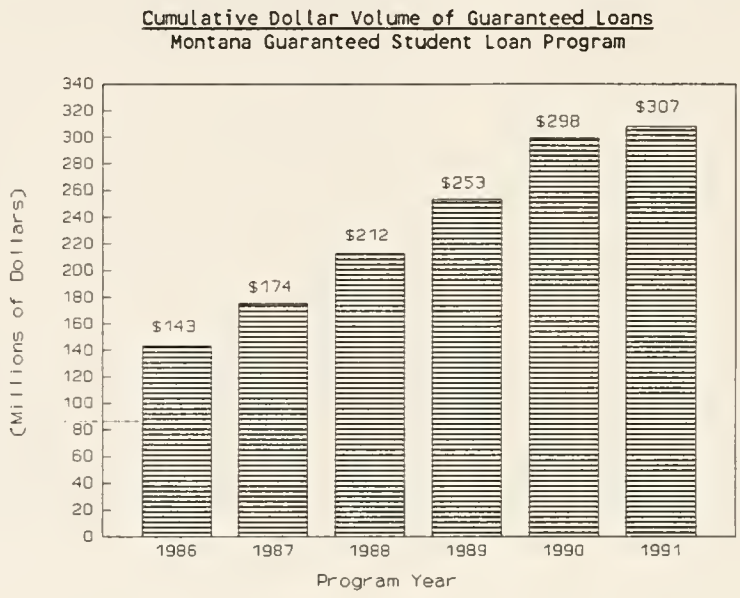
This program is funded with fees and federal administrative cost allowance payments from the Department of Education under the Higher Education Act of 1965. During fiscal year 1990-91 MGSLP guaranteed over $57 million in loans to eligible students. During federal fiscal year 1990-91, there were approximately 23,000 loans guaranteed. Cumulative volume of loans made since the inception of the program is over $300 million. The following charts illustrate the growth in the program in Montana in the past six years.

Figure 1



Source: Compiled by the Office of the Legislative Auditor from MGSLP records.

Figure 2



Source: Compiled by the Office of the Legislative Auditor from MGSLP records.

There are approximately 165 lenders and 35 in-state post-secondary institutions that participate in the loan program. Educational institutions include tribal and public community colleges, proprietary schools (barber schools, cosmetology, etc.), private colleges, vocational-technical centers, and state universities. Loans obtained by students attending out-of-state educational units represent approximately 30 percent of the total loan guarantees.

In Montana most lenders use the secondary market organization, Montana Higher Education Student Assistance Corporation. This private nonprofit corporation works closely with the MGSLP to ensure adequate services are provided to lenders and schools. Further discussion of this relationship is included in Chapter VI of this report.

Montana Guaranteed Student Loan Program Organization

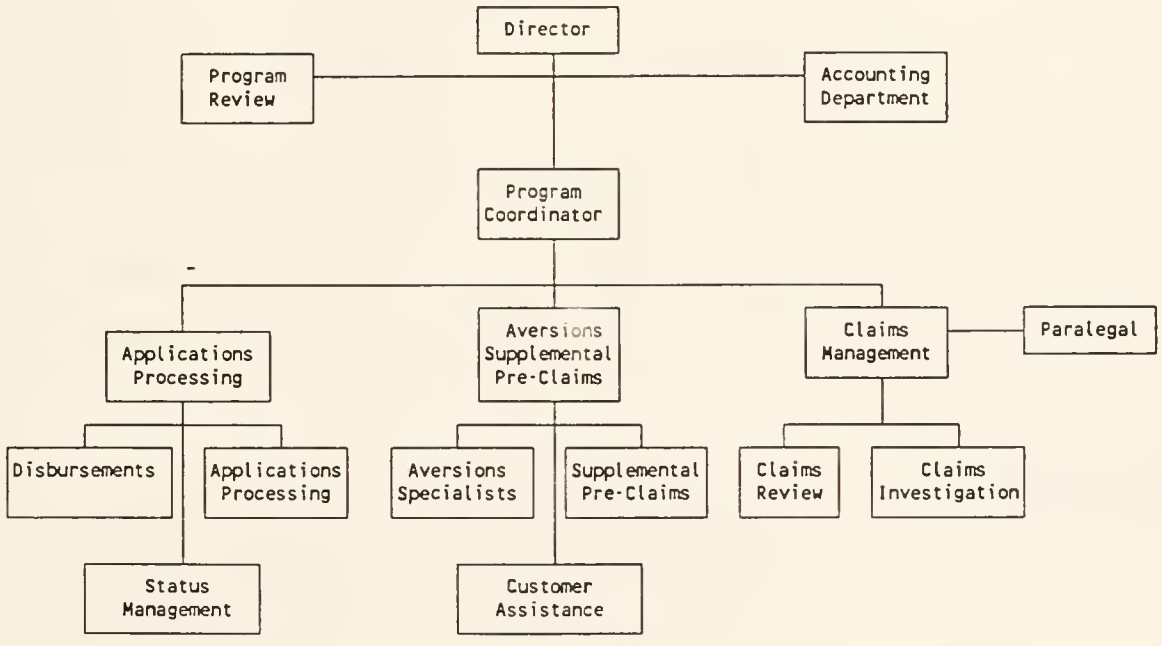
MGSLP is divided into several sections:

-- Administration and Compliance Review.
-- Fiscal and Accounting.
-- Application Processing and Status Management.
-- Pre-claims, Customer Service and Aversions.
-- Claims Management and Post-Claims Collection.

These sections are responsible for performing all duties of the program. The following chart illustrates current program organization.

Figure 3

Montana Guaranteed Student Loan Program
Organization Chart



Source: Compiled by Office of the Legislative Auditor from MGSLP records.

Some duties, such as application processing and claims management, are new. In the past these duties have been performed by a private nonprofit loan servicer, United Student Aid Funds, Inc (USA Funds). The contractor provided complete loan processing

from 1981 to 1986. In 1987 the Montana program decided to locally perform some of these duties. This change in processing has resulted in growth in staff levels from a staff size of one in 1980 to its current size of approximately 36 full-time employees.

State guarantee programs are funded through a 3 percent insurance fee paid by borrowers. In addition, the borrower (student) is required to pay a 5 percent origination fee to the Department of Education. The following chart illustrates the fiscal year 1991-92 and 1992-93 funding levels.

Table 1

Montana Guaranteed Student Loan Program Appropriations
Fiscal Years 1991-92 and 1992-93

	FY 1991-92	FY 1992-93
Personal Service	$ 929,246	$ 967,152
Operating Expenses	695,982	690,113
Equipment	135,000	135,000
Total Costs	$1,760,228	$1,792,265

Note: The funding for this program is provided through borrower fees and the federal Department of Education.

Source: Legislative Fiscal Analyst Appropriations Report.

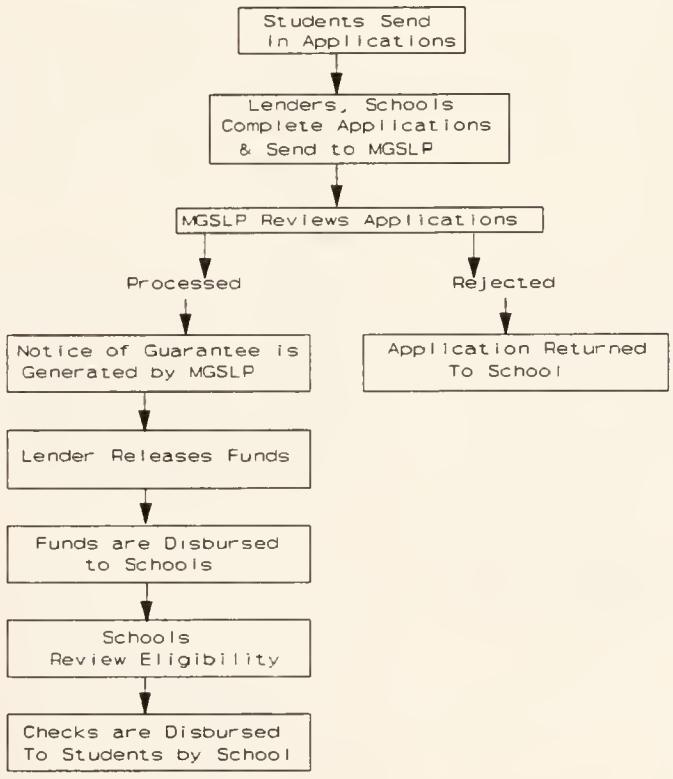
Acquiring the Loan

The loan process begins when the student applies to the school and financial need is established. The school's financial aid office certifies the potential borrower is eligible and completes their portion of the loan application. The application is then mailed to the lender for approval. When the loan is processed by MGSLP, a Notice of Guarantee is generated. The Notice of Guarantee is the lender's documentation that the loan has been processed and guaranteed. Copies are mailed to the lender and the educational unit. The loan must be disbursed in multiple installments over the academic terms. These disbursement amounts are either sent to MGSLP or directly to the school by lenders. For those lenders who have chosen to use MGSLP's

disbursement service, MGSLP prints and mails student disbursement checks to the schools. Other lenders disburse loans directly to the school or use another servicer. The school is responsible for determining if the borrower is still eligible before the checks can be released. This eligibility review includes determining if the student actually enrolls in school. The school is then responsible for the actual disbursement of checks to the borrower. PLUS loan disbursements are mailed directly to the parent. The following flowchart illustrates the process of obtaining a student loan.

Figure 4

Student Loan Application Process


Students Send In Applications
Lenders, Schools Complete Applications & Send to MGSLP
MGSLP Reviews Applications
Processed
Rejected
Notice of Guarantee is Generated by MGSLP
Application Returned To School
Lender Releases Funds
Funds are Disbursed to Schools
Schools Review Eligibility
Checks are Disbursed To Students by School

Source: Compiled by the Office of the Legislative Auditor from MGSLP records.

Process for Payment

Generally borrowers start loan payments after graduation. As long as the borrower is enrolled in school at least half-time, no payments have to be made on the loan. If enrolled in school less than half-time, payments for Stafford loans are required after a specified grace period. There is no grace period for SLS and PLUS loans. Payments begin immediately after the loan is received.

Payments can be delayed through loan deferment or forbearance. Deferment is an authorized period of time during which the borrower is excused from making payments on the loan. The borrower must request a deferment from the lender and provide documentation proving eligibility for deferment. Numerous types of deferments are available. The most common are: school enrollment on a full time basis, unemployment, temporary or permanent disability, and full-time military service.

If ineligible for a deferment but unable to make required payments, the borrower can request a forbearance. This is at the lender's option and excuses the borrower from making payments or allows smaller payments for a defined period of time. Forbearances can be granted for attending a nonparticipating institution, earning minimum wages, or experiencing an unexpected financial emergency.

When Borrower does not Make Payments

Sometimes a lender is unable to locate a delinquent borrower or unable to convince the borrower to make payment on the past due loan. When the borrower becomes ninety days past due the lender is required to seek pre-claims assistance from MGSLP. Pre-claims assistance is provided to help prevent the loan from going into default. This assistance includes ensuring all regulations have been followed and time limitations have been met. Program staff also try to get payment from the borrower. The normal time frame for a loan to go into default is six months after the borrower has failed to make payments.

MGSLP reimburses the lender for a defaulted loan. The agency then files for reinsurance from the Department of Education. The reinsurance agreement guarantees payment of the loan from the Department of Education for an amount not to exceed the amount paid to the lender. State programs are reimbursed for defaulted loans up to 100 percent from the Department of Education. Increases in the overall state default rate can effect the percent of reimbursement received from the Department of Education. MGSLP currently receives 100 percent reimbursement. The Montana default rate was 3.66 percent for the past federal fiscal year.

After a loan has been defaulted, MGSLP will contact the borrower in an attempt to correct the default. The program will work with the borrower to set up a payment plan or some type of special handling of the account. Under extenuating circumstances, the program can recommend the loan be repurchased or rehabilitated by giving the borrower an opportunity to make 12 consecutive monthly payments.

After MGSLP purchases the defaulted loans, the agency attempts to collect the loan from the borrower. These collection procedures are performed by program claims management staff and private collection agencies. If collection attempts are successful, the MGSLP can retain a percentage of the funds collected and forward the remaining collected amount to the Department of Education. Loan collections can be used by the program to fund its collection activities. In program year 1990-91, MGSLP collected approximately $9 million in outstanding loans.

Chapter III
Management Controls

Introduction

During our audit of MGSLP, we reviewed certain management controls over program operations. Management controls include policies, procedures, and established administrative processes. These controls provide a system for measurement of program activities against goals and objectives and provide managers with adequate performance information. This feedback allows program management to take corrective action when deficiencies are noted. We found there are areas with controls in place and operating as intended and areas where controls could be improved.

Controls are in Place

Our management controls testing included file reviews, staff interviews, policy and procedure reviews, and activity observations. The following sections outline areas where testing identified effective controls.

Goals and Objectives are Established

Defined goals and objectives have been established. The goals and objectives provide general direction for staff and assist in achieving program intent. Organizational goals and objectives are stated in formal documents and staff are generally aware of them. Section staff have translated organizational goals into measurable section and individual goals. Goals were available in policy and procedure manuals and position descriptions. Management generally compare these goals against program performance.

Communication is Effective

We found effective internal communication between sections within MGSLP was taking place. Section interaction is encouraged. There are timely staff and supervisory meetings. Knowledge of other sections' duties help eliminate duplication of work between sections and helps assure lender and student questions are addressed in a timely manner. As noted later in Chapter IV, lenders and schools are receiving necessary information and timely response from agency personnel. Effective communication with MHESAC also appears to be occurring. MGSLP staff at all levels indicated information was shared between the two agencies on a regular basis.

Management Information

Management information is used for making decisions relating to planning, organizing, and directing program operations. Management reports contained information needed for these purposes. We found daily, weekly, monthly, and quarterly reports are generated for section staff and supervisors. These reports are used to track program activity. Additionally, management periodically reviews and assesses which reports are still useful.

Areas Where Controls Could be Strengthened

Because of the complexity of this program and large operational changes in the past several years, program management has concentrated its efforts on specified operational areas. This has resulted in a reactive management approach that has been effective for improving operations in some areas but has postponed development of administrative responsibilities.

The following sections discuss areas where we identified potential weaknesses in management controls. By addressing these areas, the overall control of the program could be improved.

Updated Guidelines for Operational Procedures

We found a wide variety of written and unwritten policies and procedures. While procedures manuals exist and are used by staff, formats and documentation vary. Procedures actually used during day to day operations are not maintained in one manual for each section. For example, there are several "rules of thumb" followed by claims staff that are not formally documented. These include areas such as who should perform the third review of lender appeals and the acceptable minimum monthly payment levels. In some sections, written policies and procedures have been expanded by adding personal notes and memos to manuals.

Without written policies to follow, new staff may be unaware of certain requirements followed by other staff. Staff do not have one reference manual for standard procedures. With staff turnover and shifting of job duties, inconsistencies could occur. In order for manuals to be useful for backup and new employees, they should be complete and up-to-date.

Administrative Policies Should be Communicated

There is also limited communication of applicable Board of Regents' administrative policies. Areas where policies have not been communicated to all agency staff include performance appraisals, staff training and assessment, and standard office procedures. Office procedures that staff were not aware of included staff work schedules, over-time hours, and personal use of telephones. Management priorities have focused on establishing procedures for in-house loan processing. Since the majority of the program expansion was completed in 1990, we believe the program is now in a stage of development which should allow more management attention to administrative areas.

Administrative goals and objectives could be developed to ensure program staff perform duties in a consistent manner. Specific guidelines would provide direction for staff and assist in meeting program intent. To provide standard procedures for all staff, comprehensive policies and procedures should be communicated. Policies and procedures should be maintained and controlled to ensure all staff are notified of changes or new policies. This will ensure consistent manuals and provide an adequate tool for all staff.

Performance Appraisals Need to be Completed

Performance evaluations have not been completed on employees. Most employees have worked for the program for more than one year and some for several years, yet none have received a formal evaluation.

Performance evaluations provide an important avenue of feedback to employees. Performance criteria should be based on agency goals and objectives, backed by policies and procedures, and reflect current job requirements. Despite verbal feedback, without a formal appraisal, employees may not be aware of the quality of their work or areas requiring improvement. Potential exists that management could be unaware of problem areas resulting in inefficient service to students, schools and lenders. Additionally, lack of appraisals can impact employee morale. Staff expressed the lack of performance appraisals and limited feedback as an area of concern. Management indicated they are

developing a formal process for performing staff evaluations. MGSLP should finalize this process and begin performing periodic evaluations.

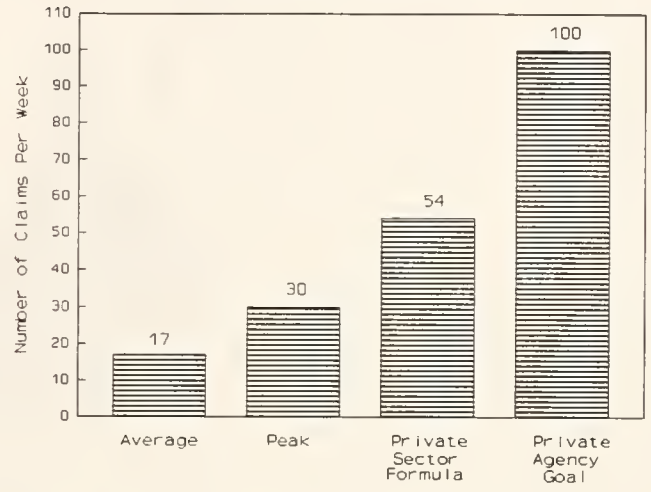
Workload Levels for Claims Review Staff

Staff workload was evaluated separately for each section. Workload levels in most sections appeared to ensure all staff are fully utilized. For example, we found use of temporary employees accounted for the program's ability to react to workload peaks in the Applications Processing section. We did note responsibilities could be added in the Claims Review Section to more fully utilize staff. This section is responsible for the actual "guarantee" of loans. Section staff are responsible for assuring lenders have followed all program regulations prior to submitting the loan for reimbursement.

There are two peak workload periods for claims reviewers--March and August. Peak workloads are handled by the full-time staff. At peak workload times, each staff member was able to work approximately 30 claims per week. The annual average number of claims worked by each claim reviewer was approximately 17 claims per week. The private agency that processed claims in the past had set 100 claims per week per reviewer as its goal. Using a workload formula developed by private claims reviewers, we calculated a staff capacity of 54 claims per week per reviewer. Our comparison of workload as summarized in Figure #5 indicates claims workload could be higher and still be addressed by current staff levels.

Figure 5

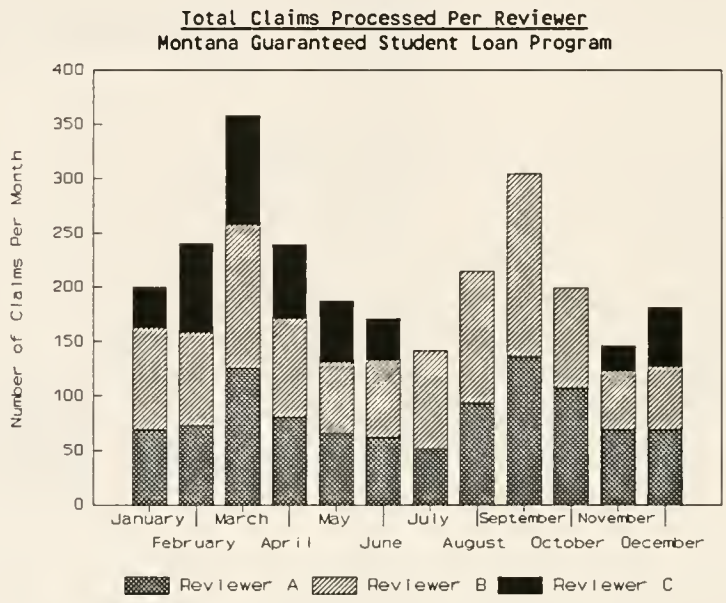
Comparison of Weekly Claims Per Reviewer
Montana Guaranteed Student Loan Program



Source: Compiled by the Office of the Legislative Auditor from MGSLP records.

Claims review staff appeared to have time to perform other tasks and there was no work backlog. One position was vacant for approximately four months and two staff members were able to keep up with all workload during that period. This vacancy occurred during a peak workload period. The following chart illustrates the amount of workload completed during the past year, including the time period when there was a staff vacancy in this section.

Figure 6



Source: Compiled by the Office of the Legislative Auditor from MGSLP records.

Claims review workload and job duties should be at a level to ensure staff are used efficiently. Claims reviewers could provide assistance in other areas. In Chapter IV, we discuss areas that could increase workload in the Program Review section. Claims reviewers could assist in lender training seminars or program reviews. Claims reviewers are already familiar with lender requirements, forms, and regulations. The agency should re-evaluate staff levels and job duties of claims reviewers to ensure staff resources are more fully utilized.

Delegate Responsibility Over Various Sections

We found the role of MGSLP management personnel has not been clearly defined. Management and supervisory duties have not been properly delegated. Section supervisors are concentrating on other tasks, such as reviewing student files, rather than conducting needed supervisory duties.

The lack of delegation of supervisory responsibilities has contributed to inconsistent oversight of staff and delays in managerial decisions. Monitoring of staff by section supervisors varies from reviewing production reports, to observing specific activities, to essentially no supervision. For example, oversight appears to take place for claims investigators but there is limited supervision of claims reviewers. Claims review is a high risk area. Errors in the claims review area could result in noncompliance with federal regulations.

The Program Coordinator makes most section managerial decisions. This often results in delayed administrative and management decisions because of the extensive travel requirements of the Coordinator's position. The Program Coordinator is also involved in making decisions on individual loan files, resulting in less time to address administrative issues. Supervisors were unsure of their roles and job boundaries in making these type of decisions. In some sections, staff view someone else as their supervisor other than their designated supervisor.

Sound management requires a clear delegation of management and supervisory responsibilities. Clear assignment of administrative functions and priorities should also be developed.

Summary

The basic task of management is to design and maintain an environment where staff can work towards meeting established program objectives. By addressing the above areas, we believe management will balance priorities in all aspects of program operation.

Recommendation #1

We recommend MGSLP establish additional management controls through:

A. Standardizing procedure manuals.

B. Communicating administrative guidelines.

C. Implementing a formal performance appraisal process.

D. Evaluating job duties and workload of claim reviewers.

E. Delegating administrative and supervisory functions.

Chapter IV
Program Reviews

Introduction

To ensure compliance with federal regulations, Guaranteed Student Loan regulations require reviews of lenders and schools that are involved in the program. These reviews are required for the ten lenders and schools with the highest loan volume. Those ten must be reviewed every two years. In Montana the program reviews are performed by MGSLP staff. MGSLP has two staff responsible for these duties; one is responsible for reviewing lenders; the other is responsible for schools. These two staff members also provide training and technical assistance for both the lenders and schools.

During our audit, we examined the program review function to determine if the process provides quality assurance over program activities. We also compared MGSLP activities to federal guidelines. The following sections outline our observations and suggestions for improvement.

Areas Where Procedures Meet Minimum Requirements

Overall, we found the program review function at MGSLP generally meets minimum federal requirements. The staff perform reviews of the ten lenders and schools with the largest loan volumes every two years. The basic federal requirements are reviewed. Training and technical assistance is provided to schools and lenders.

As part of its program goals and objectives MGSLP is committed to providing technical training and assistance to participating schools and lenders. This includes notifying units of legislative changes, outlining administrative requirements, and assisting new staff. We conducted phone surveys of schools and lenders to determine their views on the adequacy of training and technical assistance provided by the program reviewers. We contacted twelve lenders and nine schools. The comments provided during the survey indicated satisfaction with the quality of service provided by the agency. Those units contacted stated information was useful and was provided in a timely manner.

Adequacy of Other Program Procedures

To further determine if program intent is being met, we compared duties being performed to overall program goals and objectives. Based on this comparison, it appears the program could be improved to ensure prescribed goals are being met. The program reviews function at MGSLP could be a key method for measuring the program's goal of assuring quality and integrity. Current program review procedures emphasize training and technical assistance to schools and lenders rather than coordinating these activities with oversight of the program. Program review results could be used to identify potential training areas. The following sections include recommendations that could improve program oversight.

Which Schools and Lenders are Reviewed

Due to federal requirements, schools and lenders with the top ten loan dollar volume are first priority for program reviews. Statewide monitoring of other units participating in the loan program is limited. There are schools and lenders that have never been reviewed by MGSLP staff. Other lenders have not been reviewed in over eight years. Lenders with low loan activity can have high default rates. Based on the number of reviews currently being completed, the same lenders and schools are reviewed repeatedly while others may not receive in-depth agency monitoring for extended periods of time.

Program reviewers have been assigned additional duties that require their time rather than concentrating their efforts on monitoring the program. Writing and preparing program newsletters are also program review staff responsibilities. This has affected the amount of time that can be devoted to actual program reviews. Changes we are proposing, such as increased sample sizes and reviewing additional lenders and schools, would require additional staff time. Staff priorities should be redefined. Agency management should ensure that additional lenders and schools are monitored on a regular basis.

How Closed Schools are Accounted For

There is no formal agency requirement to address schools that are closing their operations. Schools that are ceasing operation are generally proprietary schools. (Proprietary schools include barber, broadcasting, and cosmetology schools.) Based on information in the agency files, it appears these schools often have financial difficulties and questions relating to their student loans. But currently staff do not review those schools or even ensure all loan records are maintained. There is no formal procedure for schools to follow or for agency staff to address in this area. In order to provide accurate management information and timely agency corrective action, agency procedures should address methods for schools to follow during their closure process.

Sampling Procedures Could Be Improved

Current agency procedures do not outline methods for calculating or projecting the error rate to the loan population. Even for those errors that are identified by reviewers, there is no formal method for corrective action. Errors that are identified by MGSLP staff are usually just corrected by school or lender staff with limited follow-up by agency staff. Improved procedures could assist in determining compliance with federal guidelines. Reviewers could also identify areas where training or technical assistance may be needed.

To illustrate the weaknesses of current procedures we used data compiled in previous reviews to estimate error rates and to determine how confident we could be in MGSLP results. We reviewed eleven lender and school program reviews that were selected from agency files. We documented the actual loan population size, sample size selected, and the number of errors identified by program staff. Using this information, we analyzed the results of the reviews by projecting the error rate noted in their findings to the entire loan population of the unit being reviewed. (Error rate indicates frequency an error will occur throughout the entire population.) The following chart illustrates our projected error rate ranges for eleven program reviews conducted by MGSLP.

Table 2

Projected Error Rates for MGSLP Program Reviews

SCHOOLS

	1	2	3	4	5	6
Loan Population	73	134	1625	2583	4067	30427
MGSLP Sample Sizes	21	21	48	43	45	57
# of Errors	5	7	21	19	9	18
Actual Error Rates at 95% Confidence	11 to 44%	16 to 56%	30 to 59%	29 to 60%	10 to 35%	20 to 45%

LENDERS

	A	B	C	D	E
Loan Population	449	484	694	2887	5169
MGSLP Sample Sizes	29	40	31	37	52
# of Errors	7	20	8	7	2
Actual Error Rates at 95% Confidence	11 to 43%	35 to 66%	12 to 44%	8 to 35%	3 to 13%

Source: Compiled by the Legislative Auditor's Office from MGSLP records.

Federal guidelines require a 100 percent review of loan files if the same problem occurs in 10 percent of the selected sample. Since MGSLP is not evaluating its review results to determine the error rates, reviewers have not required schools or lenders to review 100 percent of their files. If we assume a 10 percent error rate is unacceptable, most school and lender reviews indicate what appears to be overall unacceptable error rates; however, lenders D and E could have error rates of less than 10 percent. To get a better, more confident estimate of actual error rates, the number of loans reviewed (sample sizes) would have to be increased.

The following chart illustrates the increase in sample sizes needed to ensure 95 percent confidence. (The confidence level indicates how assured we are the sample items represent the true

characteristics of the entire population.) In all cases the current samples were too small to assure 95 percent confidence. We realize more sample items would require additional work by reviewers and may require a change in their work priorities. However, the increases needed for the additional assurance are not that large.

Table 3

Evaluation of MGSLP Sample Sizes

Schools	Population Size	Actual Agency Sample Size	Sample For 95% Confidence	
1	73	21	37	(16)**
2	134	21	48	(27)
3	1625	48	70	(22)
4	2583	43	71	(28)
5	4067	45	72	(27)
6	30427	57	73	(16)

Lenders	Population Size	Actual Agency Sample Size	Sample For 95% Confidence	
A	449	29	63	(34)**
B	484	40	64	(24)
C	694	31	67	(36)
D	2887	37	72	(35)
E	5169	52	72	(20)

**Difference in Actual Sample Sizes and Suggested Sample Sizes are noted in ( ).

Source: Compiled by the Legislative Auditor's Office from MGSLP records.

Program goals stress quality and integrity. By using statistical methods to determine sample sizes and evaluate results, the program can further rely on its methods for ensuring quality. Statistical sampling would allow more confidence in program review findings. In addition it would add independence and reliability to current procedures. This method would allow the staff to quantify the extent of a problem, if one exists. The actual accuracy of data maintained at schools and lenders could be determined. Evaluating review results could also assist in determining areas where training and technical assistance is needed. The program should develop a statistical method for determining sample sizes and for evaluating program review findings.

Quality Control Over Program Reviews

Currently there is no supervisory review of program reviewers documentation or procedures. The workpapers generated during a review do not receive any standard review. Actual duties performed are not observed on a periodic basis. We noted concerns with how samples are selected, in the procedures followed, and in the number of annual reviews performed. For example, we noted additional sample items were not selected when loan files were not available. We also found instances when data in the final written report did not correspond with information documented in the workpapers. Based on these findings, additional review is needed.

Periodically reviewing workpapers would provide management assurance of the quality of work being performed. It would also provide a method for identifying errors that are made. Periodic reviews of staff activities provide confidence the final report meets quality standards. MGSLP should establish quality control procedures to strengthen review activities and findings.

Summary

Improvements in program review procedures would increase the credibility and quality of the Montana Guaranteed Student Loan Program. Improvement would help ensure program activities are achieving established goals and objectives. Without these changes, the integrity of school and lender decisions is not closely monitored until the loans go into default. Program reviews would be a useful tool for MGSLP to actively manage the program and to further promote the quality of the program. The current focus on training and technical assistance could be balanced with oversight of program activities. These two areas could complement each other to improve the overall process. We believe MGSLP should address the above areas to strengthen the current program review function.

Recommendation #2

We recommend MGSLP strengthen the program reviews function by:

A. Monitoring additional lenders and schools.

B. Developing procedures for closed schools.

C. Developing a statistical sampling method for determining sample sizes and evaluating review findings.

D. Establishing quality control procedures.

Chapter V
Computer System Outside of Montana

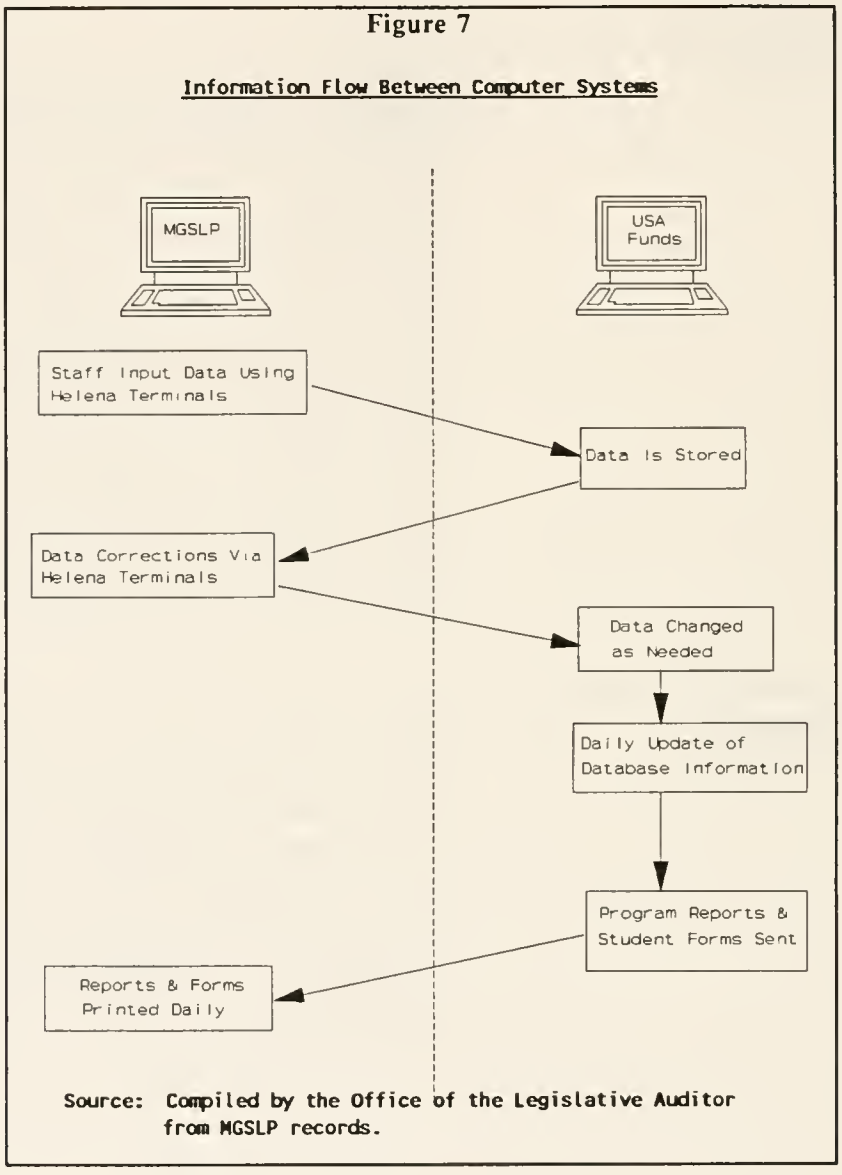
Introduction

Completed loan applications are mailed to MGSLP by lenders and schools. The application information is then entered onto a central student loan database. This database is maintained by a private loan servicer located in Indianapolis, Indiana. MGSLP accesses database information through a computer maintained in Helena. Both the Indiana and Helena computer systems are used to operate and monitor the program. During fieldwork, we reviewed controls over both the student loan database maintained by the private loan servicer, United Student Aid Funds (USA Funds), and the computer in Helena. These systems were reviewed because all program information is processed through these systems. The following sections discuss improvements that could be made in controls over the USA Funds database. Improvements that could be made over the Helena computer system are discussed in Chapter VI.

Background

MGSLP initially contracted with USA Funds to process applications, track student activity and maintain all program records. In 1987, the Board of Regents approved a plan for the MGSLP to perform some of these duties within Montana. This plan involved the gradual shift of loan processing duties to Montana. Program information is still maintained on the computer system in Indianapolis but information is entered and updated by staff in Montana. The following chart illustrates how information flows between these systems.

Figure 7


Information Flow Between Computer Systems
MGSLP
USA Funds
Staff Input Data Using Helena Terminals
Data Is Stored
Data Corrections Via Helena Terminals
Data Changed as Needed
Daily Update of Database Information
Program Reports & Student Forms Sent
Reports & Forms Printed Daily

Source: Compiled by the Office of the Legislative Auditor from MGSLP records.

During fieldwork, we reviewed controls over the student loan database including certain controls within USA Funds in Indianapolis.

Internal Audit Function is in Place

The internal audit function at USA Funds is providing increased security over controls in Indianapolis. Audit documentation was complete and easy to follow. Internal audit staff are independent from other operations staff. Policies and procedures are comprehensive and provided guidance for staff.

Internal audit work has generally addressed controls that the agency would rely on. We were able to trace internal audit report issues to changes made in response to these reports. It appears the internal audit function provides additional assurance over the controls in place in Indianapolis.

An Adequate Disaster Recovery Plan Will be in Place

USA Funds' internal auditor also reviewed the planned disaster recovery processes for USA Funds. Internal auditors reviewed the disaster recovery plan and identified some improvements that could be made. We followed up on these weaknesses and found modifications were being made. Based upon this review, we concluded the disaster recovery plan at USA Funds will ensure continued service to MGSLP within a reasonable time frame after a major disaster.

Service Agreement Could be Strengthened

We reviewed the service agreement between the two organizations, MGSLP and USA Funds. We looked for various elements which should be included in the agreement to ensure MGSLP contractually has a desirable level of service. The existing contract was compared with the suggested contract elements outlined by the American Institute of Certified Public Accountants' Audit and Accounting Guide, "Audits of Service-Center-Produced Records." We noted the following improvements could be made to the current agreement.

1. USA Funds backup procedures are not fully defined.

2. MGSLP responsibilities regarding input controls and master file changes are not detailed.

3. The agreement does not identify contact individuals within USA Funds.

4. The agreement does not identify individual(s) within MGSLP who are responsible for coordinating the services.

5. Provisions for major changes or upgrades to the computer applications are not detailed.

6. The agreement does not specify USA Funds' responsibility for maintaining system controls.

7. The agreement does not require USA Funds to provide an independent auditor's report on system controls to MGSLP.

Due to these missing elements, MGSLP lacks assurance regarding the controls within USA Funds' computer environment. Missing contract elements also increase the risk for disputes between the two organizations. Specific language related to these responsibilities would decrease this risk.

An additional area that may require contract clarification is established procedures for documenting, reviewing, testing, and approving new systems or programs. We noted the contractor did not follow a formal systems development plan during development of current applications used by MGSLP. The lack of formal procedures increases the risks in several areas. For example, management objectives may not be met or test procedures could be inadequate.

Based upon our review, MGSLP management should consider the need for additional elements in their written agreement with USA Funds. A more comprehensive agreement would also provide additional assurance that controls are in place over the electronic data. In addition, management should ensure the agreement includes a formal development plan for any future application development.

Recommendation #3

We recommend MGSLP review its contract terms with USA Funds to ensure adequate service and controls are in place.

Areas Where Controls Could be Improved

During our audit, we identified several areas where controls could be improved. By establishing these controls MGSLP will have more confidence in the information input and maintained on the computer system.

Staff Procedures Not Documented

We noted the correction procedures followed by MGSLP staff for information being added to the database are not formally documented. Documentation is not maintained after the error is corrected. Errors detected by database edits are identified on an Error Correction List. MGSLP staff members receive this list daily. Staff members review the lists and make the necessary corrections to the database. Based upon our review, the correction process is time consuming and complex. If MGSLP experience staff turnover, error corrections may be done improperly or less timely. Agency management should establish formalized error correction procedures and a method for documenting the changes made by staff. For example, the agency could list the steps required to correct application processing errors. Changes made by the staff could be documented on the database files.

Agency Management Controls Over Database Access

Access controls safeguard computer resources, data, and programs against improper or unauthorized use. We reviewed the access controls related to the database and noted several weaknesses. Improvements could be made over both internal and external access controls.

Access to database functions is controlled through the application software managed at USA Funds. MGSLP management

originally believed all changes to database access were authorized by MGSLP management. In addition, management believed only MGSLP employees had database access. While performing audit work at USA Funds, we found 265 external personnel had access to Montana's database. Sixty-nine of these individuals had some form of write or update access to the database. MGSLP management was not aware of this external access. Given the number of users who had access, MGSLP has no method of ensuring all input is controlled.

Internally, we reviewed access MGSLP employees had to the database. Of the 20 users we tested, 14 had access which was not necessary for their job duties. Many of these users need access to generate reports but they also had access to all other functions. Essentially, this gives those employees the ability to write or make changes to database information even though their job duties do not require those type of activities.

Access to data files and programs should be limited to those individuals authorized to process or maintain particular systems. MGSLP management did not know who actually had database access or if all users, internal and external, needed access to Montana's database. Management indicated documentation of this access did not appear necessary since they presumed only one MGSLP supervisor could authorize access. However, we found several MGSLP employees with database access whose access was authorized by representatives at USA Funds. MGSLP should establish procedures to control access over these areas and maintain documentation of the access given to staff.

Changes Through Tape Override

USA Funds permits lenders to create and submit electronic tapes for database update. Lenders use these tapes when requesting assistance in loan collections. Information on the tape is then compared to database information during processing. We noted the process will automatically change information on the database if the borrower's name, address, or phone number is different than data on the tape. As a result, MGSLP has no control over these input procedures to database information.

USA Funds' representatives stated they believe lenders have the most recent information related to borrowers so the system has been programmed to permit tape override of database information. However, during our testing, we found an individual whose name was incorrect on the database due to a lender tape error. If tape overrides are permitted, MGSLP should work with USA Funds to establish a method for documenting these changes.

Overall Improvements That Can be Made

We identified several areas where the agency could establish additional policies and procedures to ensure there are adequate controls over the automated student loan information. MGSLP should establish formal procedures for database correction procedures and ensure those corrections are adequately documented. Policies and procedures should also include ensuring only authorized personnel receive database access and that access is necessary for job performance. Documentation of user access should be maintained. Changes to the database information should be documented.

Recommendation #4

We recommend MGSLP:

A. **Formalize error correction procedures and establish a method for documenting corrections.**

B. **Develop policies and procedures for database access.**

C. **Develop a method for documenting database changes.**

Improvements Could be Made in Database Accuracy

The purpose of the loan database is to provide accurate reporting and tracking of student loans. To test the accuracy of database information, we reviewed a statistical sample of student loans maintained on the system. This testing does not provide assurance over data maintained by schools and lenders. The accuracy of data maintained at that level is tested by MGSLP during program reviews.

Our review included testing six different attributes, such as student name, social security number, and recorded loan amounts. We compared borrower and loan information on the database to hard copy files at MGSLP and information maintained by MHESAC. We were not able to verify the accuracy of all information on the database because source documents were not always available. For items with available source documentation, we found examples of names and loan status that were not recorded consistently. We were able to conclude with 90 percent confidence the error rates for each attribute we tested. The following list outlines the various attributes and their projected error rates.

Attribute	Error Rate Range
Social Security Number	.00 - 3.70%
Name	.60 - 9.93%
Loan Status	.10 - 7.40%
Loan Amount Approved	.00 - 3.70%
Distributed Amount Equals Approved Amount	.00 - 3.70%
Notice of Guarantee Amount Equals Approved Amount	.00 - 3.80%

Although the error rates are not unusually high, even a 10 percent error rate in the entire loan population (over 300,000 records) could indicate a large number of inaccurate records (up to 30,000 records).

Conclusion

By taking control over additional duties associated with the loan database, the agency has taken steps to control database information. MGSLP could strengthen this control by negotiating service agreement changes with its loan servicer and improving system controls. The program also needs to assure critical areas are monitored and are operating as planned. For example, access reports should be requested and reviewed periodically. Activities outlined in the service agreement should be reviewed to determine if required activities are being performed. As owners of the data, Montana needs to maintain the accuracy of loan information. By addressing the above concerns and improving controls, database accuracy should be improved.

Chapter VI
Computer Systems Maintained in Helena

Introduction

Montana Guaranteed Student Loan Program relies on a computer system leased by Montana Higher Education Student Assistance Corporation (MHESAC) to transmit loan data from their loan servicer in Indianapolis to Helena. Due to the inter-dependence of their agency operations, MHESAC and MGSLP have agreed to share resources, including the current computer staff and system maintained in Helena. Because MGSLP is responsible for program information and quality operations, we believe MGSLP is also responsible for ensuring the computer environment is adequately controlled regardless of its ownership status for equipment and staff utilized. Ultimately MGSLP is responsible for controls over its data but due to the sharing of resources, any changes in these areas will also require MHESAC staff involvement.

Because of the MGSLP reliance on information maintained on the system, we reviewed general controls over MHESAC's computer system. General controls are comprised of the following:

1. The plan of organization and operation of computer activity.

2. The procedures for documenting, reviewing, testing, and approving systems or programs and changes.

3. The existence of hardware controls.

4. Controls over access to equipment and data files.

5. Other data and procedural controls affecting overall operations.

To implement any improvements in the system will require the cooperation and support of MGSLP and MHESAC management and staff. The level of support required could be negotiated between the two agencies. In the following sections, we outline improvements and changes that could be incorporated into a written agreement between MHESAC and MGSLP in addition to areas where controls could be improved.

MHESAC Agreement Needs Clarification

MGSLP responsibility in relation to current computer operations is currently defined in a letter of agreement between the two agencies. The current agreement addresses primarily the form and frequency of billings. Other areas of responsibilities and required procedures are not adequately covered in the agreement. For example, each agency's responsibility for maintaining system controls has not been specified. Clarification of backup procedures, provisions for maintaining access security, and authority for entering transactions could be outlined.

Due to the limited information outlined in this agreement, MGSLP lacks assurance regarding the controls within MHESAC's computer environment. The missing contract elements also increase the risk for disputes between MHESAC and MGSLP. Specific language related to the responsibilities, liabilities, and data ownership of the parties would decrease this risk.

Recommendation #5

We recommend MGSLP incorporate specific language in its letter of agreement to clarify each agency's role and responsibilities regarding computer functions.

Areas Where Controls Could be Improved

We noted MGSLP has not established specific policies and procedures related to controls over the Helena computer system. The following sections discuss our findings.

Disaster Recovery Plans

A formal disaster recovery plan has not been established for Helena computer operations. Agency management has not devoted staff time to this project. This is an area that should be established as a staff priority by MGSLP management. Section 2-14-114(3), MCA, requires each department head to implement

appropriate cost-effective safeguards to reduce, eliminate, or recover from identified threats to data and information technology resources.

Recommendation #6

We recommend MGSLP ensure the necessary steps are taken to protect data by a disaster recovery plan.

Recovery From Hardware Error

Most system's software will detect and record hardware failures. Hardware errors could include failures with discs, memory boards, or the designated power supply. Without written procedures related to recovery procedures for staff to follow, actual system recovery may be delayed. We noted there are no agency procedures for the steps necessary to accomplish hardware recoveries. Industry guidelines suggest that formal procedures be established and followed for hardware recovery to ensure all information is recovered when problems occur. Procedures will ensure all staff are aware of the initial steps to follow and who should be made aware of the problem. Procedures will also help ensure consistency between all staff members and an orderly, complete recovery of the system.

Agency management indicated there are two staff members who are knowledgeable regarding hardware recovery. While these individuals are capable of completing recovery procedures, in their absence recovery could be significantly delayed. A delayed recovery could seriously affect MGSLP operations.

Recommendation #7

We recommend MGSLP develop and document hardware recovery procedures to ensure continued operations.

Is Electronic Information Secure?

Access controls safeguard computer resources, data, and programs against improper or unauthorized use. Logon IDs and passwords should control access to the department's computer systems, programs, and data. Assigning limited access based on job duties/requirements also facilitates checks and balances in the system. These controls prevent users from inadvertently or willfully executing programs or changing data unrelated to their job. We identified several areas where these type of controls were not in place. The following sections outline steps that could be taken to increase the level of security over electronic database information.

Security Access to Computer Files

Industry standards indicate the security administrator should be the only person to use the access control administration/security functions. We found six individuals with security access to computer files. Of these six, two individuals are vendor support specialists. Although computer center management indicated all these individuals need security access, we believe access could be further limited.

During our testing, we also noted five group logon IDs. One of these has security access privileges. Security privileges usually allow the user to establish new users, access all data, change system software, change user passwords, and complete system maintenance. Computer staff indicated the group logon IDs are necessary for training and for use by outside vendors. Accountability of individuals for transactions, system changes, or errors is not available when group logon IDs are used.

Given the size of this organization, we believe the number of individuals with security access within the organization should be limited. In addition, we believe security access granted to vendors should be strictly controlled and documented. It is not appropriate for vendors to have security access at all times. To further ensure system integrity, group logon IDs should also be strictly controlled. Group logon IDs should never have security access privileges since accountability is critical for security functions.

Segregation of Duties

We noted programmers have write access to both data and programs by sharing logon IDs. Programmers have write access to programs used to submit warrant information for processing. These programmers also have write access to data which is used to process warrants. Program staff have indicated that programmers have write access to data so they can make necessary corrections to data. MGSLP personnel verify these changes. However, a potential exists for one individual to create another warrant file and generate unauthorized warrants. With this shared access, employees have the potential to generate warrants for personal gain.

Segregation of functions within a computer services department includes separation between operations and programming. No one person should have write access to data and programs. The programmer who makes changes to the program should not be permitted to make data file changes.

Summary

Based on our review, it appears MGSLP has not been aware of the actual security access over electronic processing systems. There are several steps the program can take to increase controls in this area. Training can be provided to the designated security officer to provide technical assistance and to increase agency knowledge of security measures. Policies and procedures can be developed for all staff to follow. These policies should address procedures for granting access, and procedures for removing terminated employees access. Duties should be segregated between programmers and data entry staff. MGSLP should also

develop a system for monitoring controls in this area and ensuring policies and procedures are followed consistently.

Recommendation #8

We recommend MGSLP improve data security over the Helena computer system by:

A. Providing training to the designated security officer.

B. Developing policies and procedures for access controls.

C. Segregating duties between programmers and data entry staff.

D. Establishing a system to monitor access to data.

Overall System Management

The relationship and corresponding negotiated agreement between MGSLP and MHESAC has created a unique management situation. It has created a beneficial relationship in terms of communications between the agencies and a sharing of resources. However, while reviewing controls over the computer system, we noted there are some consequences of the relationship which hinder the ability of MGSLP to access computer staff expertise.

There are several computer processing areas which are lacking defined controls and established staff procedures as identified in this report. The development of these controls and polices will require the expertise of senior level computer staff. Currently, MGSLP can request about 25-30 percent of senior level staff time be spent for its operations. The remaining staff time is designated for other university and MHESAC operations. The MGSLP staff time percentage is annually negotiated with MHESAC. We believe the areas identified in this report should be established as priorities for computer staff by agency management. Database integrity and security are critical areas

for this program. Control weaknesses could affect the ability to continue operations.

Due to the good relationship between the two organizations, we believe these areas could be addressed while negotiating a new letter of agreement. The development of controls for MGSLP may require additional staff time, or a change in current staff priorities, for a limited period of time.

Recommendation #9

We recommend MGSLP establish staff priorities to address the lack of controls over the current computer systems.

Agency Response

MONTANA GUARANTEED STUDENT LOAN PROGRAM

35 South Last Chance Gulch • Helena, Montana 59620-3104
(406) 444-6594

June 12, 1992

JUN 12 1992

Scott Seacat
Legislative Auditor
Room 135, State Capitol
Helena, Montana 59620-1705

Dear Mr. Seacat:

Enclosed as per your request is the Guaranteed Student Loan Program's response to the Performance Audit Report dated June 1992.

You will note in this response that the student loan program does concur in all of the recommendations. In some instances I have explained why the agency has not implemented some of the recommendations sooner. Since 1987, when the Board of Regents directed the student loan program to begin servicing student loans in Montana through distributive processing, staff devoted all their time and resources to that goal. Now that the processing phases have been transferred, staff will have more time and experience to fine tune, enhance, and improve the management of the student loan program.

I would like to express my sincere appreciation to you and your staff for the assistance they gave the Guaranteed Student Loan Program, examination of the operations, and recommendations. Numerous hours have been spent discussing the future management of student loans in Montana. At this juncture, the agency was in need of a third party examination. The management audit forced the agency to look within.

Sincerely,

Bill Lannan

Bill Lannan, Director
Montana Guaranteed Student Loan Program

MONTANA GUARANTEED STUDENT LOAN PROGRAM
RESPONSE TO AUDIT REPORT

Recommendation #1:

A. MGSLP concurs with the recommendation. MGSLP staff are working on updating their procedure manuals to include internal policies and current procedures. We estimate a completion date of June 30, 1993.

B. MGSLP concurs with the recommendation. Administrative guidelines are established by the Montana University System and approved by the Board of Regents. Policy and procedure manuals have been placed throughout the office for employees' reference. The purpose and location of the manuals will be communicated to the employees. MGSLP will draft and recommend policy updates to the Commissioner when warranted.

C. MGSLP is governed by the Board of Regent's policies. Under Board policy, MGSLP is <u>not required</u> to conduct performance appraisals. MGSLP concurs that performance appraisals are a very important tool for providing formal feedback to employees and assessing individual goals. In August of 1990, the Professional Development Center was hired to present an eight hour workshop on developing performance appraisals. At that time it became apparent that job descriptions needed to be rewritten before accurate performance appraisals could be drafted. Since then, all job descriptions have been rewritten and performance appraisals prepared. Supervisors are scheduling performance reviews with their staff. It is the agency's goal to have a performance evaluation completed on all employees by December 31, 1992.

D. MGSLP concurs that claim reviewers could handle additional work assignments during non-peak workload periods. Additional responsibilities have been transferred to the claim reviewers to ensure their time is always used productively.

MGSLP management does not believe the industry standard quoted by the auditors is realistic for the agency given the type of service we want to provide. Prior to MGSLP initiating claim review in-house, we received numerous complaints from lenders regarding the quality of claim reviews performed by MGSLP's previous servicer. Lenders believed claims were not reviewed thoroughly and returned inappropriately. This appeared to be the result of how claims were reviewed. No communication existed between the claim reviewer and the lender to resolve questions. Reviewers worked off a check list and were not trained to conduct investigative reviews. This method allowed reviewers to process a high volume of claims but placed no emphasis on customer satisfaction.

MGSLP takes a different approach to claim review. Reviewers are responsible for conducting thorough investigation of claims the first time through. Lenders are contacted to clarify ambiguities. If needed schools, doctors, and other entities are contacted for additional information. Each claim can require anywhere from fifteen minutes to six hours to process completely.

The industry standard arrived at by the auditors is based on the private servicer. To apply this standard to MGSLP's procedure is unrealistic given the in-depth procedure management requires the reviewers to follow. It is a goal of MGSLP to handle each claim thoroughly and as few times as possible.

E. MGSLP concurs that there are gray areas in the line of authority and decision making responsibilities within the agency. After the agency's employee retreat in July 1991, an Organizational Chart Committee was formed to address the concerns expressed during the retreat. The committee has presented its recommendations to the Director. The recommendations are being considered.

Training for effective management, supervision, and delegation is being developed. Supervisors will be encouraged to attend at least one class per year provided by either in-house or external consultants. Weekly management meetings encourage open discussion between the supervisors on organizational goals and methods to achieve these goals, as well as problem resolution. Management is aware that supervisors need responsibility for decision-making. Concerted efforts are continually being made to empower the supervisors with this responsibility.

Recommendation #2:

A. MGSLP concurs with the need to monitor additional schools and lenders. It is the guarantee agency's goal to do a program review at each participating institution no less than once every five years. Some non-program review functions have been transferred to other units.

B. MGSLP concurs with the recommendation. MGSLP has included in its revised Policy and Procedure manual steps for schools to follow when anticipating closure. These include notifying the guarantee agency of the pending closure and discussion of where student records should be physically located after closure.

The Department of Education is developing closed school policies and procedures. The scope of this problem encompasses more entities than just the guarantee agency. Many of the affected students do not have student loans or financial aid. The question of who will be responsible for

retaining records after a school closure impacts more than student loan records. Other important records needing to be preserved include official transcripts, Pell Grant documents, scholarships, and workstudy credits transferable to other educational institutions. MGSLP believes legislative action is necessary in this area to provide an agency with oversight capability as well as the ability to hold the owner or director of the institution personally liable for non-compliance.

C. MGSLP concurs with the recommendation. We are participating in the recently formed Governmental Accounting/Auditing Education Network. Training for employees responsible for conducting program reviews will be developed by June 30, 1993.

D. MGSLP concurs that steps need to be taken to assure quality control. The guarantee agency is evaluating both short and long term solutions. MGSLP will be requesting a direct supervisor for this unit in FY94. This unit will be reorganized to focus on expanding and improving program reviews.

Recommendation #3:

MGSLP concurs that the contract with USA Funds needs review. MGSLP is in the process of requesting a two year extension of its servicing agreement with USA Funds. The contract will be amended to address the issues identified.

Recommendation #4:

A. MGSLP concurs with the recommendation. The error correction procedures will be formalized in the unit policy and procedure manuals. MGSLP is working with several entities developing an automated method for documenting corrections. We estimate the enhancement to be operative in FY94.

B. MGSLP concurs that access policies need to be reviewed. MGSLP has policies and procedures in place for database access. All supervisors, and USA Funds personnel, have been reminded of this policy. MGSLP has requested USA Funds provide the Program Coordinator with a complete report listing <u>all</u> persons who have access to the database by December 31, 1992, broken down by read only, input capability, and change or delete capability. Those employees who required access to MGSLP's database when USA Funds was doing full servicing for MGSLP, but who no longer have need to access the database, are being deleted. Key USA Funds personnel requiring database access will maintain that capability with full disclosure to MGSLP. MGSLP will receive a regular report identifying persons with access by types of access.

C. MGSLP concurs that changes to the database should be documented. Currently, MGSLP is restricted by the available student loan software. This system has limited means to document status changes. MGSLP is working with two student loan software companies in developing a software system that will allow some method of documenting and verifying database changes automatically.

In June 1992, MGSLP will be working with Deloitte and Touche to develop a systems requirement document for a software which provides complete audit trails of system changes, error corrections, and all phases of loan processing. In FY94 MGSLP anticipates going out to bid on the software used by the agency. Capability to document changes to the database will be a bid requirement.

Recommendation #5

MGSLP concurs that its current contract with MHESAC needs clarification. A new contract will be drafted within the next fiscal year taking the auditor's recommendations under advisement.

Recommendation #6

MGSLP concurs that steps need to be taken to protect the data. MGSLP has a verbal agreement with USA Funds to act as a "hot site" for its student loan functions. This agreement will be included in the new contract currently being negotiated. MGSLP will begin researching options to address areas not covered in the disaster recovery plan negotiated with USA Funds. It is our goal to have a disaster recovery plan by the end of FY94 which will address all areas of MGSLP's operations.

Recommendation #7:

MGSLP concurs that hardware recovery procedures need to be documented in an easy to follow, step-by-step procedure manual tailored for MGSLP. The procedure should identify contact persons and provide specific reference to industry manuals, including page numbers. MGSLP will request the document be completed by June 30, 1993.

Recommendation #8:

A. MGSLP concurs that there are benefits of having a designated security officer in the agency. An employee will be designated as our security officer by December 31, 1992. MGSLP will ensure that a detailed daily reporting of all system access is generated for this person's review.

B. MGSLP concurs with the recommendation. The computer center manager has deleted the five group logon IDs and restricted access to others on an as needed basis. Strict monitoring occurs when vendors have access. MGSLP will work with the computer center manager to develop reasonable policies and procedures governing access controls.

C. MGSLP concurs with the recommendation. MGSLP has taken steps to train guarantee agency staff to perform the data entry duties previously performed by programmers. MGSLP will continue to implement new procedures to ensure segregation of duties between programming and write access. It is anticipated that the required procedures will be in place by December 31, 1992.

D. MGSLP concurs with the recommendation. MGSLP has developed a check list for hiring and terminating staff. The check list defines the procedure for requesting and deleting computer access for employees. The Secretary for the Program Coordinator has been assigned the responsibility for monitoring the access to data.

Recommendation #9:

MGSLP concurs with the recommendation. MGSLP will be requesting one FTE for a full time computer programmer/technician in FY94. In addition, the agreement with MHESAC regarding the shared use of the computer center and its staff will address the allocation of personnel time and resources to ensure MGSLP's needs are met. MGSLP and MHESAC have worked very closely in the past to provide a fair and equitable allocation of shared resources.